findings

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Access to capital for local services

A project by Richard Stanton at the London Research Centre explores ways in which capital can be secured for investment in local public services in England. It looks at them comprehensively, as a system embracing Housing Corporation finance and private investment as well as capital allocations to local authorities, and draws comparisons with France and Denmark. The researcher concludes that there is extensive central government control not just over the total amount of resources for local public investment but also over the way these funds are finally applied. The study found:

Increased central control has come about partly through the 1989 Act machinery for allocating spending power direct to local councils, and partly through distribution mechanisms, such as the shift towards discretionary allocations and the diversion of resources into funding quangos. Ministers' accountability for the way they control local government finance has dwindled.

Capital receipts have so far played a vital role in sustaining local authority investment programmes under the 1989 Act system, but cannot be relied on as their mainstay in the longer term.

Competitive bidding procedures can carry a substantial 'entry cost' in both financial and institutional terms.

Partnership with other agencies, increasingly with private investors, is becoming the obligatory route to realising capital schemes in many service areas.

The researcher concludes that:

The more local public investment comes to depend on private capital, the less it is likely (at any given level of public subsidy) to be distributed according to levels of socio-economic need.

Strong centralisation of basic decision-making and a highly restrictive timeframe for central government allocations exposes local authorities to massive uncertainty and jeopardises their efficient and effective use of capital finance.

Local authorities should be given greater autonomy as investors, especially by allowing them more options for securing capital.

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Introduction

Under the 1989 Local Government and Housing Act central government has a tight grip on authorities' ability to use their own capital receipts and grants, including those from the European Union. The Act enables Ministers to exercise complete control over authorities' access to credit through:

- the Annual Capital Guideline (ACG), defining each council's supposed relative need for capital spending;
- the Basic Credit Approval (BCA), derived from ACG, fixing a corporate entitlement to credit;
- and Supplementary Credit Approvals (SCAs) tied or 'hypothecated' to specified works.

Since 1990 two other capital sources have assumed a growing role in funding local public investment: the Housing Corporation and the private sector.

Disparate as they are, these funding sources nevertheless form an interconnected system. The research project aimed to find out how far that system ensures accountability for allocation and investment decisions, promotes efficiency and effectiveness and matches investment capacity to need.

Central control

Across both local authority and housing association sectors, Ministers are able widely to target resources to particular districts, investment models, service areas, or specific schemes.

- ***Split of resources between programmes:*** The pattern of local investment is partly determined by central government decisions on the division of nationally available resources between spending categories and programmes, for example:
  - local authority Housing Investment Programme (HIP) vs. Housing Corporation's Approved Development Programme (ADP)
  - local authority managed schools vs. grant-maintained schools
  - mainstream ACG allocations vs. Single Regeneration Budget (SRB).
- ***ACG criteria:*** For most services, criteria applied to set each council's ACG effectively impose ministerial priorities on local capital programmes.
- ***HIP allocation process:*** Ministers assert their priorities most systematically in the HIP process, distributing housing ACG using allocation criteria which mostly favour, for example, private and voluntary sector provision, land disposal, and owner-occupation.
- ***Advance of the SCA:*** The Supplementary Credit Approval, which Ministers can tie explicitly to specified investment, has assumed a major role in the provision of credit to local authorities, representing 35 per cent of all credit approvals in 1994/95.
- ***Housing Corporation: Approved Development Programme:*** Geographical distribution of ADP funding is determined mainly by an objective needs indicator. But the Secretary of State for the Environment exerts decisive influence on the way capital may be applied by:
  - prescribing 'programme balance', crucially the ratio of housing for sale to housing for rent
  - laying down criteria for the discretionary part of ADP distribution.
- ***Single Regeneration Budget:*** The advent of the SRB subjected virtually all government funding for urban regeneration to a process of competitive bidding resting on ministerial discretion.

Local authorities' access to capital: other key features

- ***Restricted timeframe:*** Authorities are typically notified of credit approvals and capital grants only a few months before the start of the financial year to which they apply. Notice of SCAs may be even shorter. None of these allocations may be carried forward between years.
- ***Capital receipts:*** Capital shortage has left authorities heavily dependent on capital receipts to sustain investment programmes. There is serious doubt whether they can continue to play this role. 'Set-aside' receipts are often effectively supporting capital expenditure already; the inflow of new receipts is widely expected to dwindle over coming years.

Accountability

As Ministers' control over local investment has increased, their accountability for the way they exercise it has withered. There are exceptions. In central government allocations for non-housing services, for example, and in the needs-based aspect of HIP allocation, allocation criteria are mostly clear-cut and appear to be well understood. But in general accountability has declined under the impact of three political developments:

- ***Administrative powers:*** Of the battery of methods for asserting central control, sketched above, none is required by the 1989 Act. They have generally been installed by Ministers using administrative powers with minimal prior public scrutiny or debate, in an area with far less profile than revenue finance.
- ***The drive for discretionary allocation:*** Whether published criteria are opaque and largely subjective (HIP process) or operationalised (SRB), Ministers cannot be held to account for decisions avowedly made at their discretion.
- ***Devolving responsibility:*** Accountability is eroded when allocation is devolved to non-departmental bodies like the Housing Corporation and the Funding Agency for Schools.

Efficiency and effectiveness

In certain respects the post-1990 system has encouraged investors to make better use of available capital; for example, many local authorities have improved corporate methods for analysing investment options. But there are grounds for concern about the system's implications for efficiency and effectiveness.

- ***Discretionary competitive procedures:*** Partly this is to do with the shift towards discretionary, competitive procedures where 'partnership' is effectively a condition of entry. The use of allocation criteria that are not explicit, objective or clearly structured (notably in the HIP process) makes it hard to judge efficiency/effectiveness in the initial allocation, to monitor subsequent performance, and to assess how useful are the criteria themselves.

Bids to fund projects this way generate external costs which may be substantial, such as 'entry costs', financial and institutional, to the bidder; and the distortion of investment choices, sacrificing schemes with higher priority or larger long-run return to fund lower-priority schemes more likely to attract potential partners.

- ***Central control:*** The tension between centralisation and efficiency/effectiveness is illustrated, for example, by Housing Corporation funds being channelled into owner-occupation, despite evidence of excess local demand for housing to rent; or the hypothecation of councils' SCA (and some ACG) resources to service areas or projects, undermining their corporate procedures for investment appraisal.
- ***Timeframe:*** Very short notice of annualised allocations means widespread waste. For instance, authorities are obliged regularly to commit staff time to planning projects for which resources may never materialise.
- ***Combination:*** centralisation plus timeframe: It is the conjunction of tight time limits with centrally-imposed constraints on how funds may be applied, creating a double rigidity in the use of capital, which most gravely threatens efficiency and effectiveness:

  Need to spend vs. investment need: The financial imperative ('get the money spent') may displace the concern to use capital efficiently. The study found:
  - a central government department issuing SCAs to councils at the end of the financial year to meet its annual targets, with no serious appraisal of local need for that category of investment
  - councils desperate for capital allowing service departments to use SCAs for low-priority schemes, just because "if they don't use it, it's gone".

  Uncertainty: Above all, dependence on ministerial decisions about the end-use of capital allocations will compound the deep uncertainty created for local investment planners by very short timescales.

Matching investment capacity to need

Access to capital has become increasingly divorced from need analysed in objective terms. There are three key reasons.

Expansion of central control

Ministers' power to determine distribution and use of capital is increasingly exercised according to policy goals rather than objective needs-based criteria. For example:

- dividing national local government capital resources politically between programmes, with no attempt to demonstrate relative need for 'top-sliced' applications
- rise of the discretionary, hypothecated SCA
- extension of ministerial discretion to 60 per cent of HIP allocation
- the increasing proportion of discretionary and demand-led elements in Housing Corporation ADP
- introduction of competitive funding programmes, especially SRB, where outcomes depend finally on ministerial judgement not objective needs criteria.

Dependence on capital receipts

The system gives this resource a crucial role in funding local authority investment, hence in meeting need. Its mechanism for redistributing credit resources to councils with fewer receipts cannot fully compensate for differences in access to receipts - as determined by historically derived property portfolios and local economic conditions.

Pressure to use private sector partners

The more local public investment comes to depend on private capital, the less it is likely (at any given level of public subsidy) to be distributed according to levels of socio-economic need.

The limited evidence so far available on private funding for public service facilities indicates that perceived commercial risk is likely to vary directly with the degree of socio-economic deprivation among the proposed clientele, and probably also with the extent of deprivation in the surrounding area. To offset that risk, or reduce financial exposure to it, the investor will look for public subsidy - usually in capital form. The distribution of private investment is therefore likely to follow the pattern of socio-economic need only if access to public sector capital resources is distributed on the same basis. This is exactly what the present capital financing system does not offer.

Comparative case studies: European Union countries

Comparison with corresponding regimes in France and Denmark calls into question the values and policy choices which have shaped the main characteristics of the English system, above all its centralisation. In France, crucially, local authorities can borrow without central government intervention, backing this unfettered use of credit with extensive revenue funding drawn mostly from local property taxes. In Denmark's case, abundant income from local taxation is local authorities' main source of funds for capital programmes. Access to credit, though constrained, is in some respects more assured and flexible than in England, and anyway plays a lesser role.

Though they signal some potential problems, especially in the French case, these studies together suggest the key to more accountable and efficient local public investment resources - particularly credit, proceeds of local taxation, or both - which they can then use at their own discretion.

Recommendations

Analysis of the English system, and comparison with its French and Danish counterparts, leads to the following recommendations:

Basic aims

If it is to promote accountability and render local public investment more fully efficient and effective, reform of the current system should focus on enhancing *the autonomy of the local authority as investor*. Local authorities should be given:

- more options for securing capital including:
  - greater freedom to use capital receipts at their own discretion;
  - greater scope to fund investment by borrowing, in a timeframe consistent with practical demands of investment schedules;
  - increased local revenue-raising capacity.
- freedom of choice on 'partnership', by:
  - ending political and financial compulsion to use private capital and multi-agency structures;
  - allowing such structures to develop as part of an overall capital programme for which the authority has clear responsibility.

Matching resources to need

Extending the range of capital resources at authorities' disposal may well widen disparities between them. Central government should therefore gear its capital allocations much more rigorously to the task of compensating for differences in needs and resources - as it already does for revenue finance.

Accountability and central government allocations

Central government's capital distribution methods should be opened up to public scrutiny, for example by:

- reviewing capital provision for different sectors, institutions and service areas, setting out publicly the grounds on which it has chosen to favour some over others;
- reducing the proportion of resources allocated by ministerial discretion;
- returning responsibility for capital allocation from 'devolved' bodies explicitly to decision-makers who are directly open to political challenge.

About the study

The project covers the main investment categories under local authority control: housing, education, personal social services, transport and 'other services'. First it describes methods used to decide the distribution of capital for such investment, by agencies in the public, housing association and private sectors which together constitute the system under review. Secondly, it examines how that system is experienced in practice by English local authorities, drawing on case studies of a small sample of them as well as statistical and documentary material for all authorities. Thirdly, the system is evaluated against the criteria of accountability; efficiency and effectiveness; and ability to match investment capacity to need. Finally, it is put in international perspective with brief comparative studies of the approach adopted for the local government sector in France and Denmark.

Further information

For further information, contact Richard Stanton on 0171 627 9629 at London Research Centre, 81 Black Prince Road, London SE1 7SZ. The full report, Funding the Fabric: Access to capital for local services is published by Public Finance Foundation, CIPFA, 3 Robert Street, London WC2N 6BH (Tel: 0171 895 8823, Fax: 0171 895 8825).

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The following *Findings* look at related issues:

25 The effect of Standard Spending Assessments (Oct 93)
26 Implementing the Council Tax (Apr 94)
31 The operation of the non-domestic rate (Nov 94)
32 The feasibility of a local sales tax (Jan 95)
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For further information on these and other *Findings*, contact Sally Corrie on 01904 654328 (direct line/answerphone for publications queries only).

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